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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 119

JAMES DONEGHY AND ST. LOUIS UNION TRUST COMPANY, RESIDUARY TRUSTEES UNDER ITEM 23 OF THE LAST WILL AND TESTAMENT OF JAMES C. DONEGHY, DECEASED, PETITIONERS

v.

ACEL C. ALEXANDER, FORMERLY COLLECTOR OF INTERNAL REVENUE

No. 120

JAMES DONEGHY AND ST. LOUIS UNION TRUST COMPANY, RESIDUARY TRUSTEES UNDER ITEM 23 OF THE LAST WILL AND TESTAMENT OF JAMES C. DONEGHY, DECEASED, PETITIONERS

v.

H. C. JONES, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court of the United States for the Western District of Oklahoma

(R. 22–29) is not officially reported. The opinion of the Circuit Court of Appeals (R. 111–115) is reported in 118 F. (2d) 521.

JURISDICTION

The judgments[1] of the Circuit Court of Appeals were entered March 6, 1941 (R. 115–116). The petition for certiorari was filed June 2, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Circuit Court of Appeals erred in ruling that taxpayer's basis for determining gain or loss upon the sale in 1930 of a portion of his beneficial interest in a trust was not increased by reason of his acquisition of an additional interest in 1918.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 9–14.

STATEMENT

The facts as disclosed by the record and the opinion of the District Court (R. 22–29) may be summarized as follows:

Doneghy Investment Company was a corporation organized in 1904 under the laws of the Indian

[1] Both cases here involve the same question and were consolidated for trial in the District Court and for argument in the Circuit Court of Appeals. The cases were disposed of in a single opinion, with separate judgments (R. 115–116).

Territory for the purpose of dealing in lands and interests in lands in the Territory. Its authorized capital was $100,000, of which shares in the amount of only $80,000 were ever issued. J. C. Doneghy subscribed and paid for $51,000 of the stock, and four others subscribed for $29,000. Thus Doneghy became the owner of 51/80ths, or 63¾ percent of the outstanding shares, the others taking 29/80ths, or 36¼ percent. Upon its organization, Doneghy became president and manager of the corporation. The board of directors adopted resolutions vesting in him full authority to act in behalf of the company in the purchase and sale of lands. It was further provided that he was to receive no salary for his services, but was to be paid his actual expenses plus one-half of the net profits of all transactions (R. 42–43).

The corporation continued to deal in land investments until 1915. However, the constitution of Oklahoma, adopted in 1907, had in general prohibited corporations from holding title to farm lands within the State, and an act of the legislature had provided that corporations owning such lands (outside of cities and towns) should dispose of them within seven years from May 26, 1908. In order to comply with this statute, the stockholders of the corporation entered into a trust agreement dated April 26, 1915, providing that the corporation should convey all of its lands to Doneghy as trustee, and that he should dispose of them as soon as he deemed it to be to the best interests of the

parties. The agreement further provided that Doneghy should first deduct all his actual expenses, then deduct for his services one-half of the net profits from the sale of the lands and distribute the remainder to all the stockholders (including himself) in proportion to their stock ownership (R. 45, 23–24).

J. C. Doneghy continued to manage the lands under the trust agreement until it was modified by a supplemental agreement of March 18, 1918, which authorized him, as trustee, to continue selling the land and property as seemed to him for the best interests of the parties. The modified agreement further provided that he should deduct his expenses from the proceeds of sales and pay to the beneficiaries the sum of $80,000 (the amount originally invested in the stock of the Doneghy Investment Company) in the ratio of their previous interest in the corporation, and should then distribute the balance among the beneficiaries on the basis of 81⅞ [2] percent to Doneghy and the remaining 18⅛ percent proportionately among the others. Doneghy continued as trustee and manager of the property through the calendar year 1930, the tax period here involved (R. 47, 24–25).

Doneghy filed personal income tax returns regularly through 1930. He reported no capital gain or income upon the dissolution of Doneghy Invest-

[2] The 81⅞ percent figure is numerically equal to the sum, under the 1915 agreement, of Doneghy's 50 percent plus his 63¾ percent of the remaining 50 percent.

ment Company and distribution of its assets in 1915 (R. 27), nor did he report any gain for 1918 by reason of acquisition of an additional interest in the trust (R. 83–89, 27).

In 1930 J. C. Doneghy sold to his nephew, James Doneghy, an undivided one-fourth interest in the Doneghy trust, which was approximately 30.53 percent of his 81⅞ percent beneficial interest in the trust. The consideration which he received was $62,500 (R. 48, 62, 26). In his income tax return for 1930, Doneghy claimed to have sustained a loss of $31,850.96 by the sale of that portion of the trust interest. The loss was determined by taking $94,350.66 as the cost basis for the interest sold (R. 55, 61–62). Doneghy subsequently asserted that the loss was in fact even greater, and that by reason of mistake there had been an overpayment of the tax. The Commissioner, on the other hand, determined that the taxpayer had realized a gain upon which a deficiency tax was assessed. The determination was based upon a reduction of the taxpayer's cost basis for the beneficial interest which he acquired upon formation of the trust in 1915, and upon disallowance of any cost basis for the additional interest in the trust acquired under the supplemental agreement of March 18, 1919. The tax as finally determined by the Commissioner was paid, and separate claims for refund of the alleged overpayment and the asserted deficiency were submitted and rejected (R. 25–26).

All of the issues in the cases were decided by the District Court for the taxpayer, except that no cost was allowed for the acquisition in 1918 of the additional interest in the trust. The District Court found that the acquisition of the additional interest was without consideration on the part of the taxpayer and that it was in the nature of a gift or donation by the other beneficiaries under the trust (R. 27–28). The suits to recover the overpayment and to recover the deficiency were consolidated for trial in the District Court. In the former judgment was entered for the Collector for costs (R. 105–106), and in the latter for the taxpayer in the amount of $7,831.07, with interest (R. 32–33). The Circuit Court of Appeals affirmed the decision of the District Court (R. 115–116).

ARGUMENT

Under the 1915 agreement, Doneghy was to retain one-half of the net profits, after deducting expenses, and then to distribute the remainder to the beneficiaries in proportion to their stock ownership. And since Doneghy was a stockholder he would also receive 63¾ percent of the distribution of the remainder.

The 1918 supplemental agreement simply provided a different method for the distribution of the assets and profits among those beneficially interested. After deducting expenses, $80,000 was to be divided among the stockholders in accordance with their proportionate interests in the corpora-

tion; and the remainder was to be distributed, 81⅞ percent to Doneghy, and 18⅛ percent to the others proportionately.

The sole issue is whether the 1918 supplemental agreement operated artificially to increase Doneghy's cost basis in the enterprise. The court below correctly held that the 1918 agreement did not increase his basis. It merely established a different method of distributing the proceeds of the enterprises and did not increase Doneghy's capital investment which could be returned to him free of tax. The District Court found, contrary to petitioners' contentions, that Doneghy's consideration for his additional interest did not include any compensation already accrued in his favor under the 1915 agreement; and the court below concurred in that finding (R. 27–28, 114). True, the court below accepted petitioners' contention that the additional interest was not a "gift"; but that concession is entirely consistent with its conclusion that the consideration did not include compensation for *past* services. And, of course, to the extent that his apparent increase in the enterprise was merely in recognition of the *future* compensation that he would otherwise receive under the old agreement, it cannot serve to increase his basis. Cf. *Hort* v. *Commissioner,* No. 517, 1940 Term, decided March 31, 1941.

Petitioners' various contentions, which in essence charge the court below with ignoring the facts found by the District Court or those disclosed by

the pleadings, are without substance. The sole issue is whether, upon the undisputed facts, Doneghy was entitled to an artificially stepped-up basis, and the court below correctly ruled in the negative.

Nor is certiorari warranted on the so-called estoppel issue. The court did not rest its decision upon that ground. It simply indicated at the end of its opinion (R. 114–115), by way of dicta, that in any event, Doneghy was not entitled to an increased basis since he had not in fact reported any gain for 1918 with respect to the transaction which petitioners now urge as the foundation for a stepped-up basis.

CONCLUSION

The case turns on its own facts and no general question of federal law is involved. There is no conflict of decision and no sufficient reason for further review. The petition should therefore be denied.

Respectfully submitted.

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